

Welcome to Edition 16 of The Newsletter from Scott H. Novak, Attorney at Law. The Newsletter is designed to bring timely and interesting topics to accountants and attorneys. Comments and suggestions are always welcome. Feel free to call or write at any time.

Are Your Clients Getting Audited Less?

Is it an illusion or are higher net worth clients getting audited less and low income individuals getting audited more? It is no illusion. There are two types of audits - correspondence audits and face to face audits. Correspondence audits account for about 75% of all audits. The more complicated a return is, the more chance that it will require a face to face audit.

Correspondence examinations are generally performed by lower level IRS employees who are called tax examiners. The IRS currently employs 969 tax examiners (down from 1,151 in 2010). Tax examiners are trained on a few of the major issues that arise on low income returns and are not required to have accounting skills. Correspondence exams are less burdensome for taxpayers than in-person audits, as they simply require the taxpayer to mail in their documentation. These exams cost the IRS approximately \$150 on average.

Tax Compliance Officers (TCOs) conduct face to face audits. The IRS currently employs 572 TCOs (down from 1,407 in 2010). The most difficult exams are performed by Revenue Agents (RAs). There are currently 6,463 RAs (down from 8,553 in 2010).

Many of the low income exams involve the Earned Income Tax Credit (EITC). This is a "refundable" credit for certain people who work and have earned income. A refundable credit is a credit whereby a taxpayer may be eligible to receive an amount that exceeds the amount paid in taxes. This is a net cost to the government (other taxpayers, in reality). Over 26 million taxpayers receive over \$64 billion in EITC benefits. The EITC has been associated with taxpayer abuse and significant levels of error. In 2018, just over 26 million returns claimed the EITC and 330,461 EITC audits were closed. The numbers for 2017 were similar. That is an audit rate of about 1.2%. EITC audits are the most efficient use of IRS examination resources, with the average audit taking 5 hours to complete. The number of low income EITC audits skews the audit rate such that it gives the appearance of low income, rural areas being targeted the most for IRS audits.

As a sharp contrast, returns with \$10 million or more of income were audited at a rate of 8.1% for 2018, for a total of 1,903 audits closed. The IRS estimates that it takes between 61 and 251 hours per return to close an audit at this level.

Congress is aware that there are many more audits of lower income individuals than higher income individuals and has asked the IRS what it intends to do to close the gap. Hundreds of thousands versus thousands. The IRS indicated in a September 8, 2019 letter to Congress that they cannot simply reallocate resources used for single issue correspondence audits to more complex higher income audits. The experience and skillset

simply will not allow for it. IRS also stated that its highest rate of attrition is among the better trained, more experienced auditors. Replacements take 2-3 years to train. It also stated that in the long-term, Congress must fund the IRS and the IRS must then hire and train appropriate numbers of RAs to have appropriately balanced coverage across all income levels.

So if it seems like your clients are being audited less, even the ones that earn well below the \$10 million mark cited above, it is true. The IRS simply does not have the resources to adequately audit higher income individuals. Until this issue is corrected, the number of lower income individuals audited will continue to appear to be well out of proportion to the number of higher earners audited.

Taxation of Vape Businesses in New Jersey

For a time, it seemed like vaping and e-cigarette businesses were popping up all over New Jersey at a rapid pace. It took some time, but the New Jersey legislature determined that these shops could add a new potential source of revenue. Call it a sin tax or simply a revenue raiser, here is what vape shops are responsible for. In addition to the same sales and income taxes that other businesses pay, they were first required to file a Form TPT-FL. This form required the vape shop to take inventory at the close of business on September 28, 2018 and to report the liquid nicotine inventory on Form TPT-FL in order to pay what is called a "floor tax." The tax was then calculated at a rate of \$0.10 (ten cents) per fluid milliliter. The form and the tax were originally due on October 20, 2018, but was delayed until December 20, 2018 and then again to January 21, 2019.

Following the floor tax, a monthly tax was instituted that requires the filing of Form TPT-10. Each month, in addition to the regular sales tax, vape shops must pay \$0.10 per fluid milliliter of liquid nicotine sold.

Withholding for Workers in the Gig Economy

In September, the IRS came out with a new tool to try and help people who earn part of their income from self-employment and part from either regular employment or pensions. The new Tax Withholding Estimator tool on the IRS website makes it easier to determine how much should be withheld from regular employment earnings or from one's pension to cover earnings from self-employment. The Estimator takes the deduction for self-employment into account and can account for several types of income, including a spouse's income.

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